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ACCOUNTING RECOGNITION FROM ISLAMIC PERSPECTIVE

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Abstract: *This research aims to identify the fundamental principles of accounting recognition from Islamic perspective. The research data was collected through several interview sessions with Islamic scholars who have vast experience and knowledge on Islamic business and fiqh mualamat. The research findings indicated that five fundamental principles derived from the interview sessions. The principles are avoidance of Riba, Gharar, Maysir, Haram and Ghalat. Theoretical and practical implications of the paper as well as suggestions for future research were also discussed.*

Keywords: islamic principles, accounting recognition, riba, gharar, maysir, haram, ghalat

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1. Introduction

Over the past decades, Islamic accounting has received a greater attention from various parties such as accounting standards-setting bodies, Islamic institutions, business corporations and researchers (Haniffa and Hudaib, 2007; Muhamad Sori, 2017; Toseef Azid, 2018; Wardani and Sari, 2018). Such attention indicates that Islamic accounting is significant topic that is widely discussed and researched in the current business and economic contexts (Alazzani, Wan-Hussin, and Jones, 2017; Susela, Hooper and Davey; 2006). It also reflects a strong aspiration to ensure current accounting practices are in accordance with Islamic teachings and traditions (Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) (2015); Muhamad Sori, 2017).

Generally, accounting is a process of providing useful financial information for users to make rational decisions and judgments (Khoramin, 2012; Scott, 2015). Islamic accounting as a branch of accounting, focuses on objectives and functions in achieving moral and practical goals consistent with Sharia principles (Baydoun and Willett, 2000; Khoramin, 2012). Accounting either conventional or Islamic normally involves three main issues, namely, recognition, measurement and disclosure. This research focuses on recognition issue from Islamic perspective since it relates to timing issue which is an important element of accrual accounting (Bergmann, 2009). In addition, recognition is the turning point whether elements of financial statement such as asset, liability, revenue, expense and equity are recorded into an entity accounting system and disclosed on the financial statements and notes (Bergmann, 2009). Scholars also argue that there are conflicts of Islamic accounting and conventional accounting that required further research

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and explanation (Baydoun and Willett, 2000; Muhamad Sori, 2017; Khoramin, 2012; Velayutham, 2014). Thus, it is important to study fundamental principles of accounting recognition from Islamic perspective.

The research is structured as follows. Section 2 highlights literature review related to objective of this paper. Section 3 explains methodological aspect of this research. Research findings are then discussed in Section 4. Conclusions, implications and future research are presented in Section 5.

2. Literature Review

As mentioned earlier, conventional or Islamic accounting normally concerns on main three issues, namely, recognition, measurement and disclosure. This research focuses on recognition issue. Accounting recognition is a test to determine whether economic transactions that occur for an organization are related to the elements of financial statements (such as asset, liability, revenue, expense and equity/net asset) or not. Recognition also involves timing when an accounting transaction to be recorded in accounting system and then presented in financial reporting. In general, there are two main criteria of the recognition. An element of the financial statements will be recognized if they meet the definition and can be measured reliably (Abdul Rahim, 2010).

However, besides the above mentioned criteria, this research suggests that the transactions should also conform to Islamic principles that derived from the Holy Quran, the practices of Prophet Muhammad Peace be Upon Him (PBUH) (Hadith), religious scholars (Ulama) and argument by analogy in legal and theological areas (Qiyas) (Napier,2009; Susela, Hooper and Davey; 2006; Trokic, 2015; Uddin, 2015). As scholars argued, conventional accounting are based on economic rationalism, while Islamic accounting fundamentally comes from Allah Subhanahu Wa Ta'ala (SWT) that emphasizes on justice, honesty, kindness and ethics. Thus, a growing belief that some aspects of conventional accounting are not compatible with Islamic beliefs and values (Baydoun and Willett, 2000; Khoramin, 2012; Velayutham, 2014; Trokic, 2015). Lewis (2001) also mentioned that conformity with the principles give accounting transactions its religious identity and differ from conventional accounting. Thus, it is imperative for this study to further identify fundamental principles of accounting recognition from Islamic perspective.

3. Research Method

The interviewees of this research were three Islamic scholars who have vast experience and knowledge on Islamic business and fiqh mualamat. This research utilized open-ended interview method for data collection method (Gubrium & Holstein, 2002). This method is suitable since the researchers wanted to limit the questions that are posed to the scholars. It also allows the researchers to gather, analyze and compare the data systematically within a short period of time (Gubrium & Holstein, 2002). The research data was collected in 2018. Three months were taken to complete the interview sessions and each session took around two hours. In addition, the interview sessions were carried out on the agreed time and day.

Each audio-recorded conversation with the scholars was transcribed and transformed into a text. Due to small numbers of interviewees, the texts were analyzed manually and completed within

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one month. To gain significant themes and statements from the transcribed texts, the researchers had analyzed them carefully several times. The interviewees were also contacted several times in order to reduce personal bias and validate the data.

4. Research Findings

To achieve the research objective, the following question was posed to the scholars during the interview sessions: "*What are the fundamental principles of accounting recognition from Islamic perspective*?". The scholars mentioned that besides meeting their definitions and can be measured reliably, accounting transactions can be recognized as long as they do not involve Riba, Gharar, Maysir, Haram and Ghalat. The descriptions of the principles are dealt with in the following sub-sections.

4.1 Riba

The first principle explained by the scholars is avoidance of Riba. It is perhaps the most controversial aspect of Islamic accounting (Lewis, 2001). In general, Riba has several meanings such as to increase, to grow, to grow up, to exceed or be more than. Riba is widely understood as usury or interest payable on loan of any kind (Haqqi, 2009; Lewis, 2001; Uddin, 2015). Prohibition of Riba is mentioned several times in the Quran (QS Al-Rum 30:39; Al-Nisa 4:161; Ali-Imran 3:130-132 and Al-Baqarah 2:275-281). For instance, Allah SWT states that: "*O you who have believed, fear Allah and give up what remains [due to you] of interest, if you should be believers. And if you do not, then be informed of a war [against you] from Allah and His Messenger. But if you repent, you may have your principal - [thus] you do no wrong, nor are you wronged"* (QS Al-Baqarah 2: 278-279).

Condemnation of Riba is also supported by Hadith. Prophet Muhammad PBUH *"has cursed the one who accepted Riba, the one who paid it, the one who recorded it, and the two witness of it, saying they were all alike"* (Narrated by Muslim). To avoid Riba The Prophet PBUH also states that: *"(Exchange) gold for gold, silver for silver, wheat for wheat, barley for barley, dates for dates, salt for salt, measure for measure and hand to hand. If the (exchanged) articles belong to different genera, the exchange is without restraint provided it takes place in a hand to hand transaction"*(Narrated by Muslim, as cited in Uddin, 2015, p.3).

Riba involves in transactions such as payment of an addition by the debtor to the creditor in exchange of commodities of the same kind. Riba can also arise from interests on loans, credit cards, saving and fixed deposit accounts and overdrafts with conventional banks and financial institutions (Uddin, 2015). From the above discussion, it can be concluded that the payment and the taking of Riba as occurs in conventional accounting transactions is prohibited by Islam. Therefore, investments or contributions must be compensated by other means such as profit sharing (Lewis, 2001).

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4.2 Gharar

Avoidance of Gharar is the second fundamental principle stated by the scholars. It is literally means "hazard". Although, it is a relative concept when it comes to business risks, accounting transactions involving Gharar is prohibited by Islam since they have elements of deceit, speculation, excessive risk, fraud, uncertainty, and something which in its manner and its consequence is undetermined. Such elements might lead to destruction or loss or consuming other people's property unjustly (Lewis, 2001; Gharyani, 2002; Uddin, 2015). Gharar is not stated clearly in the Quran, however, Allah SWT mentions that: *"And do not consume one another's wealth unjustly or send it [in bribery] to the rulers in order that [they might aid] you [to] consume a portion of the wealth of the people in sin, while you know [it is unlawful]"* (QS Al-Baqarah 2:188).

The banning of Gharar is also mentioned in Hadith. For instance, Prophet Muhammad PBUH has forbidden "*the purchase of the unborn animal in its mother's womb, the sale of the milk in the udder without measurement, the purchase of spoils of war prior to their distribution, the purchase of charities prior to their receipt, and the purchase of the catch of a diver"* (Narrated by Ahmad and Ibn Majah, as cited in Uddin, 2015, p.4). Uddin (2015) concludes that Gharar is any accounting transaction of probable objects whose existence or description are not certain, due to lack of information and knowledge of the ultimate outcome of the contract or the nature and quality of the subject matter of it.

Gharar arises from the transactions like derivatives instruments, short-selling contracts (Uddin, 2015) and conventional insurance (Lewis, 2001). Thus, it is important for contracting parties to have perfect knowledge on the details of their accounting transactions in order to avoid Gharar.

4.3 Maysir

The third principle found during the interview sessions is avoidance of Maysir or literally means gambling. It is also known as games of chance or hazard. In this sense, the gambler strive to amass wealth without effort (Lewis, 2001). The winner simply takes the wealth from the loser without creating new stock of wealth (Abu Bakar Ahmad, 1992; Uddin, 2015). This unjustified enrichment through pure chance is condemned by the Quran and Allah SWT said that:"*O you who have believed, indeed, intoxicants, gambling, [sacrificing on] stone alters [to other than Allah], and divining arrows are but defilement from the work of Satan, so avoid it that you may be successful"* (QS Al-Mai'dah 5:90).

Business transactions contain element of gambling if their gains are derived from mere chance, speculation or conjecture (Hameed, 2009; Siddiqi, 1985). The examples of transaction include contracts involving pure speculation and chance, conventional insurance and derivatives (Lewis, 2001; Uddin, 2015). Therefore, accounting transactions that contain element of Maysir should be avoided since they cannot be recognized from Islamic perspective.

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4.4 Haram

The fourth principle specified by the scholars is Haram. Haram means activities or items forbidden in Islam (Lewis, 2001). These include forbidden of trade of alcoholic beverages or intoxicants which is clearly mentioned by Allah SWT in the Quran (QS Al-Mai'dah 5:90). There are also a number of Hadith dealing with the issue. For instance, Anas said that Prophet Muhammad PBUH has cursed ten people in connection with wine: "*the wine-presser, the one who has it pressed, the one who drinks it, the one who conveys it, the one to whom it is conveyed, the one who serves it, the one who sells it, the one who benefits from the price paid for it, the one who buys it, and the one for whom it is bought*" (Narrated by Tirmizi and Ibn Majah, as cited in Saadi Abu Habib, 1988, p.183).

Business activities involving pork meat or swine is also Haram (Lewis, 2001). Allah SWT mentioned that: "*He has only forbidden to you dead animals, blood, the flesh of swine, and that which has been dedicated to other than Allah. But whoever is forced [by necessity], neither desiring [it] nor transgressing [its limit], there is no sin upon him. Indeed, Allah is Forgiving and Merciful*" (QS Al-Baqarah 2:173). Al-Qaradawi (1997) added that the transactions involving generally prohibited foods, idols, crosses, statues, and the like are also Haram in Islam since they can encourage individuals to commit sins.

Prior to recognition of any accounting transaction, it is suggested that entities should refer to Fatwa Committee or to establish Religious Supervisory Board (Lewis, 2001). They can act as independent advisors to assess the Halal and Haram of the transactions in question. This is important since today's accounting transactions are so complex and diverse.

4.5 Ghalat

The avoidance of Ghalat is the fifth principle found in this research. Ghalat means mistake, error, misunderstanding or erroneous belief. From business perspective, Ghalat is a negative element which can affect the validity of an accounting transaction or a contract (Abu Zahrah, 1996; Mustafa Ahmad Zarqa, 2012). Thus, the offer and acceptance of a transaction or contract which focus on the rights of contracting parties, and rules are utmost important in Islam. For instance, if a buyer finds that the features of the item purchased differ from what have been described by the seller, or the item has a defect, he has the rights to revoke or maintain the transaction (Syed Ahmad Hashmi, Bilal Aziz - Ahmad Farhan and Asyraf Azahar, 2014). In accounting context, cancellation of the transaction may affect recognition of several accounts such as liability (for instance, account payable) and asset (for example, inventory).

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5. Conclusion, Implication and Future Research

The purpose of this research was to identify the fundamental principles of accounting recognition from Islamic perspective. Several interview sessions with the Islamic scholars found that avoidance of Riba, Gharar, Maysir, Haram and Ghalat are additional principles of accounting recognition from Islamic perspective. Therefore, respective entities have to ensure that their accounting transactions do not contain these prohibited elements. Having such elements result in the transactions cannot be recognized although their definition and measurement criteria are met.

This research has implications to theory and practice. Theoretically, this research develops a greater understanding on fundamental principles of accounting recognition consistent with Islamic norms and values. Practically, the information about the principles can be utilized by Islamic institutions (for instance, institutions that manage zakat, waqf and baitulmal) to ensure their accounting transactions are Sharia compliant.

Findings of this research are derived from opinions of a few scholars, therefore, they are limited in terms of generalization. Further research could interview more Islamic scholars to further validate the research findings and identify other Islamic recognition principles that are not reported in this research.

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